No. 3920.

# United States Circuit Court of Appeals

## For The Ninth Circuit

FIDELITY AND DEPOSIT COMPANY OF MARYLAND, a Corporation, and MARYLAND CASUALTY COMPANY, a Corporation. *Appellants,*

vs.

KELSO STATE BANK, an Insolvent Banking Corporation, and JOHN P. DUKE, as Supervisor of Banking of the State of Washington, in Charge of and Liquidating the Assets of the KELSO STATE BANK, *Appellees.*

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON
HON. R. S. BEAN, *District Judge.*

## APPELLANTS' BRIEF


McCAMANT & THOMPSON,
Northwestern Bank Bldg., Portland, Ore., and
GRINSTEAD & LAUBE,
314 Colman Bldg., Seattle, Washington,
*Solicitors for Appellants.*
WALLACE McCAMANT, Portland, Oregon, and
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THE ARGUS PRESS, SEATTLE

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# APPELLANTS' BRIEF

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## STATEMENT OF THE CASE.

The Kelso State Bank of Kelso, Cowlitz County, Washington, closed its doors and was taken over by the banking department of the State of Washington on March 17, 1921. (R. 13, 31). At that time, the County Treasurer of Cowlitz County,

Washington, was credited on the books of the bank with deposits of funds belonging to Cowlitz County aggregating $64,460.96 (R. 15, 16, 31), which were secured by depository bonds in the total penal sum of $70,000.00 theretofore executed by the appellants, as sureties, and the Kelso State Bank, as principal; the Fidelity & Deposit Company of Maryland having executed, as surety, two bonds in the penal sum of $40,000.00 and $10,000.00, respectively, and the Maryland Casualty Company having executed one bond in the penal sum of $20,000.00. After the bank closed, appellants paid the County Treasurer the amount credited to him on the books of the bank plus $31.53 interest, the Fidelity & Deposit Company of Maryland paying five-sevenths of this amount, or $46,066.06, and the Maryland Casualty Company paying two-sevenths, or $18,-426.43 (R. 20, 21, 35). Upon making payments to the County Treasurer, the appellants took assignments of the claims of the Treasurer and of Cowlitz County against the Kelso State Bank (R. 256-262).

The County Treasurer had deposited county funds in the Kelso State Bank at various times prior to the 17th day of March, 1921, the last two deposits being made on March 9, 1921, and March 14, 1921, respectively (R. 17, 33). The deposit of March 9, 1921, amounted to $6,752.55 and included one check signed by Ida C. Oxtoby, drawn on a San Francisco bank in the amount of $5,136.41, payable to the County Treasurer in payment of taxes due Cowlitz County (R. 177, 204). The deposit of March 14,

1921, amounted to $35,337.57 and included a draft of the Puget Mill Company on Pope & Talbot of San Francisco for $32,897.97, payable to the Treasurer of Cowlitz County in payment of taxes due caid county (R. 177, 207).

On March 14, 1921, and after receiving the deposit of that date from the County Treasurer, the cashier of the Kelso State Bank took the Pope & Talbot draft for $32,897.97 and some other cash items amounting to $6,500.00 to the United States National Bank of Portland and used the same in repurchasing certain warrants which had theretofore been sold by the Kelso State Bank to the United States National Bank of Portland under certain repurchase agreements (R. 163, Plts. Ex. 27A-27B), (R. 162, 197, 198), using for this purpose the sum of $33,491.59, the amount due the United States National Bank of Portland on the repurchase agreements (R. 165).

Upon repurchasing the warrants, the cashier of the Kelso State Bank left them with the United States National Bank of Portland and instructed it to place them in its safe keeping department and mail receipt therefor to the County Treasurer of Cowlitz County and to advise said Treasurer by telephone that the warrants were being held as security for the deposits of county funds of Cowlitz County in the Kelso State Bank (R. 165, 239). The United States National Bank of Portland did advise the Treasurer of this fact by telephone and issued receipt for the warrants as directed, but, by mis-

take, mailed the receipt to the Kelso State Bank (R. 165). The warrants are still in the possession of the United States National Bank in its banking house in Portland, Oregon, and said bank was made a party defendant to this action. At the trial, the United States National Bank disclaimed any interest in the warrants and offered to turn them in to the registry of the court and the court issued its order, pursuant to agreement of the other parties to the suit, directing said bank to keep the warrants until further order of the court and discharging said bank from liability (R. 63). The United States National Bank is not, therefore, interested in or a party to this appeal.

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Appellants claim that they are entitled to recover said warrants upon the grounds, as alleged in the first cause of action of their amended bill of complaint:

1. That the moneys deposited in the Kelso State Bank by the County Treasurer on the 14th day of March, 1921, were deposited at a time when the Kelso State Bank was hopelessly insolvent within the knowledge of its officers and, by reason thereof, the title to the money did not pass to the bank, but constituted a trust fund in the hands of the Kelso State Bank, as Trustee, which trust fund was used to repurchase said warrants.

2. That the warrants in question were pledged as security for the deposits of the County Treasurer of Cowlitz County in the Kelso State Bank and that

appellants, as successors in interest of the County Treasurer and of Cowlitz County, are entitled to the possession of them so that they may be applied in payment of the County Treasurer's claim against the Kelso State Bank, which claim has been assigned to appellants.

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When the Kelso State Bank closed, there was cash on hand amounting to $17,189.32 (R. 93), and appellants, by their second cause of action, seek to recover this sum as a portion of the moneys deposited in the Bank by the County Treasurer under such circumstances that the title thereto did not pass to the Bank and that this much of the money so deposited by the County Treasurer remained in the Bank at all times after the same was deposited and passed into the hands of the defendant, John P. Duke, as Supervisor of Banking.

The court dismissed the amended bill of complaint and denied appellants any relief.

## ASSIGNMENT OF ERRORS.

Appellants assign errors as follows:

I.

That the court erred in dismissing the amended bill of complaint for want of equity.

II.

That the court erred in finding the issues in favor of the appellees.

III.

That the decree is against the manifest weight of evidence.

IV.

That the decree is contrary to law.

V.

That the court erred in failing to find the issues in favor of appellants on the first cause of action set out in the amended bill of complaint herein.

VI.

That the court erred in failing to find in favor of the appellants on the second cause of action stated in the amended bill of complaint herein.

VII.

That the court erred in holding that the warrants described in said complaint were not deposited with the United States National Bank of Portland, Oregon, as security for County funds deposited in the Kelso State Bank by the County Treasurer of Cowlitz County, Washington.

VIII.

That the Court erred in failing to find that the warrants described in the amended bill of complaint were deposited with the United States National Bank of Portland, Oregon, as security for deposits of public moneys which the County Treasurer of Cowlitz County, Washington, had on deposit in the Kelso State Bank on the 14th day of March, 1921.

IX.

That the Court erred in holding that the officers

of the Kelso State Bank did not believe that said bank was hopelessly insolvent on and prior to the 14th day of March, 1921, and at the time when the deposits of public moneys belonging to Cowlitz County, Washington, were made in said bank by the County Treasurer of Cowlitz County, Washington.

X.

That the Court erred in failing to find the warrants described in the amended bill of complaint were purchased or repurchased from the United States National Bank of Portland, Oregon, by the Kelso State Bank with moneys belonging to Cowlitz County, Washington, which moneys were trust funds in the hands of said Kelso State Bank.

## ARGUMENT.

The decision in this case involves both questions of fact and of law. As this is an equity case, it is tried in this court *de novo* and, if the lower court erred as to findings of fact or conclusions of law, this court will remedy that error so that complete justice may be done the parties.

*Central Improvement Co. vs. Columbia Steel Co.*, 201 Fed. 811.

Appellants base their right to recover the warrants on two separate grounds:

*First*: That these warrants were purchased by moneys deposited by the County Treasurer of Cow-

litz County, Washington, in the Kelso State Bank under such circumstances that *title to the same did not pass* to the Kelso State Bank, but remained in the County Treasurer and that these appellants, as sureties, on the bonds of the Kelso State Bank to the County Treasurer are subrogated to the rights of the County Treasurer to recover the same.

*Second*: That *the warrants were pledged* by the Kelso State Bank with the United States National Bank of Portland as security for the deposits of the County Treasurer in the Kelso State Bank.

If appellants are entitled to recover the warrants on the first ground above stated, the second becomes immaterial; and, likewise, if they are entitled to recover on the second ground, the first becomes immaterial.

## I.

## Title Did Not Pass.

The Kelso State Bank was hopelessly insolvent within the knowledge of its officers when it received the deposit of March 14, 1921.

It is alleged in paragraph VI of the amended bill of complaint:

> "That, on the 17th day of March, 1921, said Kelso State Bank, being insolvent, refused to discharge its obligations in the ordinary course of banking business, and its affairs and assets were taken into the possession of said Claude P. Hay, then Bank Commissioner of the State of Washington, for liquidation and distribu-

tion; that ever since said 7th day of March, 1921, said Claude P. Hay, as Bank Commissioner, and said defendant, John P. Duke, as Supervisor of Banking, as successor to Claude P. Hay, has been and now is in possession of the business and affairs of said Kelso State Bank for the purpose of liquidating and administering the same; that, on the 17th day of March, 1921, said Kelso State Bank was and ever since has been and now is insolvent." (R. 13).

The answer to this paragraph is as follows:

"Answering paragraph VI these defendants admit that the said Kelso State Bank was on the 17th day of March, 1921, taken possession of by the banking department of the State of Washington for the purpose of liquidation, but these defendants allege that the affairs of said bank are now being liquidated by T. H. Adams, Special Deputy Supervisor of Banking of the State of Washington Liquidating the Kelso State Bank." (R. 31).

By failing to deny the allegations of the complaint relative to insolvency, respondent admitted the same.

The uncontradicated testimony of T. H. Adams, Special Deputy Supervisor of Banking and the officer in charge liquidating the Kelso State Bank, is:

"To sum it up substantially, the aggregate of the claims that have been approved is something in excess of $360,000.00; and there is

about $40,000.00 more claims that are asserted and still undetermined." (R. 99.)

"We have paid out in dividends twenty per cent of this $360,000.00; and a little more than $1,000.00 preferred; which would amount to approximately $73,000.00 that has been paid in dividends, including the preferred." (R. 99.)

"If I might be permitted to sum it up about this way, that if the worst happened to us that could happen or that might happen in this matter, the litigations, and so on, that we might pay only ten or fifteen per cent more. If the best happened that could happen, we might pay thirty-five or forty per cent more. Eliminating the possibility of suit against the Board of Directors, I would say that forty per cent more is the maximum."

"In giving these figures, I have figured in returns from assessments levied on the stockholders; of which everything has been collected except Stewart's." (R. 97.)

The witness further testified that the bank was capitalized at $25,000.00 and that there had been collected between $12,000.00 and $13,000.00 from stockholders, (R. 100.) and, in order to pay forty per cent more, the bank must recover the sum of $20,000.00 from the surety on the cashier's bond. (R. 97.)

It, therefore, appears that, in order to pay a maximum dividend of not more than sixty per cent, the bank must recover approximately $33,000.00

which could not be considered assets in determining whether it was solvent. Eliminating this $33,000.00, the bank had assets, at the best, worth about $175,000.00 and, at the worst, about $130,000.00, while its liabilities amounted to between $360,000.00 and $400,000.00.

The condition of the bank on March 14, 1921, when it received the deposit from the County Treasurer, was no better than when it closed. None of the uncollectible claims originated subsequent to January 27, 1921, (R. 103) and it received from depositors approximately $23,000.00 more than it paid out after the close of business on March 12, 1921, which was the last banking day prior to March 14th. (R. 283-Deft's Ex. C.) This, of course, included the deposit of the County Treasurer on March 14, 1921.

It is apparent from the above admissions and evidence that the bank was hopelessly insolvent on March 14, 1921.

### Knowledge of Officers.

The evidence clearly showed that the officers of the Kelso State Bank knew that it was hopelessly insolvent when the deposit of March 14th, 1921, was made.

The appellees, in their answer, alleged:

> "That during the time mentioned and referred to in the bill of complaint herein for several years prior thereto one F. L. Stewart was employed as the Cashier of the Kelso State

Bank and entrusted with the general management of the affairs of the bank and given control and possession of the funds, securities and properties of the bank; that from time to time the said F. L. Stewart juggled the accounts, misused and appropriated the funds of the bank, misused and mismanaged the assets of the institution and loaned the funds of the bank to irresponsible persons and by reason thereof the bank became unsound and the supervisor of Banking of the State of Washington took charge for the purpose of liquidating the affairs of the bank, and that during such time and at the time the deposits were made by the County Treasurer of Cowlitz County with the said Kelso State Bank the directors and other officers of the bank had no actual knowledge that the funds of the bank had been appropriated and embezzled by the cashier, and had no actual knowledge that the bank had become unsound or in an unsafe condition to continue business." (R. 38, 39.)

Mr. Adams testified:

"Of Mr. F. L. Stewart's indebtedness to the bank, there is one $6,000.00 item and two items of about $5,000.00. I am speaking of the notes Mr. Stewart had in the bank. He was not indebted to the bank in the sum of over $100,000.00 in one way or another. He had placed in the bank certain paper, and in one way or another had taken credit for that, which I am

unable to realize on, if I can realize on at all; but there are some $55,000.00 that I have based claim against the bonding company on as having been illegal. Unless I can recover from the bonding company in that suit, that $55,000.00 is hopelessly lost. I have heard the administrator of the Stewart estate say that Stewart is absolutely insolvent; and he told me it was useless to file a claim; and that is my judgment of it." (R. 102, 103.)

"In my answer, I have alleged and believe it to be true, that F. L. Stewart, Cashier of Kelso State Bank, was guilty of criminal misconduct of the affairs of the bank. I do not believe I would want to undertake to say how much of the amount of money that was unlawfully abstracted by Mr. Stewart from the assets of the bank would be criminal and how much would not be. I do not think I would be competent to pass on that, but some $60,000.00 has been taken from the bank in one manner or another by the sale to the bank of doubtful or worthless paper, or on his own note, or on some sort of paper or security that could be carried as an asset, which I think I would be safe in saying have no value as far as that amount of money is concerned. If I my explain my meaning, take a note of $8,000.00 on which Mr. Stewart benefited $1,000.00; there will be more than $1,000.00 loss on that. And if I may put that construction on it, the entire

fifty-five or sixty thousand dollars is lost to the bank.

"The capital of the bank was $25,000.00 and its surplus was claimed to be $25,000.00; and in my opinion Mr. Stewart abstracted from the bank a larger sum of money in assets than its entire capital stock and surplus." (R. 107, 108.)

"The abstraction of assets from the bank by Stewart ran as far back as 1913, and probably before that. It was a sort of a case of robbing Peter to pay Paul. The first abstraction that we have discovered was a case wherein Mr. Stewart put some note in the bank, apparently his own, and credited an estate of which he was administrator. We were not able to determine why he credited the estate, but we assume that he had used the money of the estate and was replacing it. He probably replaced that note with something else at a later date. That was quite frequently done, that some of the paper that he was directly or indirectly responsible for would be paid by the substitution of something else which he was still responsible for in some form or other; and that condition obtained for a long time." (R. 110.)

On May 26, 1919, the Directors of the Kelso State Bank accepted a personal guaranty from the Cashier of notes and mortgages "up to a sum not to exceed $50,000.00." (R. 108, 223.)

By letter of December 13, 1920, the Bank Com-

missioner notified the Cashier that a large amount of paper which the bank was carrying would have to be charged off or collected at once and generally criticized the condition of the bank, ending the letter as follows:

> "The above instructions have been given only after the most careful consideration of the report of examination and of the events which occurred during the time the writer was in your bank at the time of the examination. I recall your statements with respect to many of the items listed above and believe that you feel that some of them are too severely criticized. I am frank to say, however, that I am convinced you are misleading yourself, and that before the entire matter is cleaned up your bank will have suffered a severe loss. You will consider the above instructions as definite. You will report to this department not later than December 31, 1920, showing what progress you have made toward complying with these instructions.
>
> "You will report again not later than March 15, 1921. Your failure to show proper progress can only result in a special examination being made of your bank in order that we may determine what will be the proper course to pursue toward eliminating the objectionable items." (R. 228, 229.)

It is submitted that the above letter was notice to Stewart that failure to improve conditions prior

to March 15, 1921, would result in a closing of the bank. It would seem evident that a special examination, after such notice, of a bank which was so insolvent that its assets were not worth more than fifty per cent of its liabilities would result only in such action.

The Examiner's report of November, 1920, listed $114,041.15 of the bank's loans as subject to very severe criticism. (R. 213.) The condition, as outlined in that report, was called to the attention of Mr. Stewart, the Cashier, and Mr. Wallace, one of the directors. (R. 113.)

On March 6, 1921, the Bank Commissioner called a meeting of the officers and directors of the Kelso State Bank at Chehalis, Washington. At this meeting Mr. Carothers, President of the Bank, Mr. Plamonden, Assistant Cashier of the Bank and Mr. George Marsh, a director of the Bank, were present. The Bank Commissioner called their attention to the condition of the bank and notified them that an assessment on the capital stock of the bank would be levied immediately. On March 7, 1921, a 100% assessment was levied and the directors notified. (R. 118, 119, 219, 220, 221.)

Following the meeting at Chehalis on March 6, 1921, and the levy of assessment on March 7, 1921, Mr. George F. Plamonden, Assistant Cashier, Mr. Stewart, Cashier, Mr. Carothers, President, and Mr. Plamonden's brother made an examination of the assets of the Kelso State Bank, which examination was completed on the night of March 13, and

a report of the same sent to the Bank Commissioner under date of March 14, 1921. (R. 145, 146, 229, 233.) We quote from that report as follows:

"Nearly all of the paper in his cases can be classified as petrified assets, very little liquid, and the larger part valueless. I cannot see how it can ever be worked out as matters now stand, unless Mr. Stewart is able to pay a large part of his liability in cash and thus reduce the loans to a point justified by the deposits. I calculate Mr. Stewart's liability as follows:

| | |
|---|---|
| Notes to bank as maker and endorser | $20,352.40 |
| Amount necessary to redeem stock now held by First National of Portland as collateral | 14,000.00 |
| 100% assessment on 124 2/3 shares | 12,466.67 |
| Special guarantee on notes | 50,000.00 |
| | $96,819.07 |

It will be absolutely out of the question in my mind for the reorganizers to take that much of Stewart's paper even though it be fully secured, for we shall find ourselves in the same condition as the bank now is, as to reserves, in a very short time, and therefore still pressure must be brought to bear on Stewart to get some money and at least reduce his liability to $50,000.00 of well secured stuff. Should Stewart be able to do this, then I believe the bank will be solvent, though yet petrified to a somewhat lesser extent (sort of a semi-petrification, may

I say) but in a condition that can in the course of a year or two be worked out without loss to depositors or shareholders. At the present time I do not see anything to sell" (R. 230, 231).

On March 14, 1921, Mr. George F. Plamonden, Assistant Cashier, wrote a letter to the Bank Commissioner in which he stated that Mr. Stewart had apparently made no effort to arrange his part of the solution, except that he was planning to go to California at an early date and that it would be impossible for them (referring to himself and his brother) to accept Stewart's paper on a guaranty for $96,000.00. He said this letter had been written after a conference with Mr. Carothers and requested the Bank Commissioner to come immediately to Kelso (R. 234, 235).

Mr. George F. Plamonden, Assistant Cashier, testified that, about a week before the bank closed, about the 10th of March, 1921 (R. 161), he had a conference with Mr. Stewart relative to what he (Stewart) would do in the event of the worst coming to the worst, in which he said: "Fred, in the event it were possible that you could not do your part in this, you would not do anything rash, now, would you?" (R. 147). He further stated that Stewart said that, in any event, he would not be silly enough to do anything rash, make away with himself, or anything of that sort (R. 148). He further testified that Mr. Stewart had sent a block of notes to a New York Bank for rediscount and that credit had been refused (R. 158).

All of the above testimony is uncontradicted and all of it was given by witnesses who were connected with the Kelso State Bank as officers, or with the banking department of the State of Washington. All of these witnesses were friendly to the appellees and were very careful to give their testimony in such manner as would indicate that they, personally, did not believe the bank was hopelessly insolvent prior to the time it closed. It was to their interests to favor appellees as much as possible in order to avoid criticism or possible criminal liability if they should admit that the bank was permitted to remain open after it had become hopelessly insolvent. However, we do not believe that any construction can be placed on this testimony other than that the bank was not only hopelessly insolvent, but that its insolvency was due to wrongful acts on the part of the Cashier and that the officers had full knowledge of its condition, at least on the 14th day of March, 1921, after the completion of the examination of the assets by the President, Cashier and Assistant Cashier of the bank.

The evidence above referred to clearly shows that the officers of the Kelso State Bank knew of its insolvent condition, at least prior to March 14, 1921. However, if they had not, in fact, known of its condition, the law would imply knowledge.

It is presumed that the officers of the bank knew that it was insolvent.

*Beal v. City of Somerville*, 50 Fed. 647.

"If one is a banker or person doing a bank-

ing business and receives on deposit the money of his customer, it is to be presumed that he knows, at the time of receiving such deposit, whether or not he is solvent. At all events, as he holds himself out to the public and to his customers as being possessed of money and capital, and therefore safely to be trusted, it is his duty to know, and he is, under all ordinary circumstances, bound to know, that he is solvent, and it is criminal negligence for him not to know of his own insolvency. * * * A man holding himself out as banker thereby gives public proclamation that he has money and property readily convertible into money in possession and subject to his control, and for that reason may be safely trusted. It requires no argument to show that such assurance is most inviting and influential with the mass of people, especially with those unacquainted with the history and character of the man. With them the banker is intrusted with money merely because he is a banker and hence supposed to have surplus capital as a standing guaranty of his agreements and his integrity. For an insolvent banker, company, or corporation to continue the business of banking is to hold out assurances of responsibility and surplus capital where neither exists. To do so knowingly is to secure the confidence and hence obtain the money of the ignorant and unwary by an implied deception."

3 R. C. L. 494, 495.

The Supreme Court of the State of Washington has stated the rule in no uncertain terms, in the case of *State v. Welty*, 118 Pac. 9, as follows:

> "Under our statute knowledge of the bank's condition is both presumed and required. *'It is the imperative duty of such officers, when they receive deposits from the bank's patrons, to know that the bank is solvent*, and if, under the circumstances, by the exercise of reasonable diligence such fact could have been ascertained, if by the exercise of such diligence in making an examination and inquiring in respect to the solvency or insolvency of the bank its true condition could have been discovered, then under such circumstances the presumption will be that they had knowledge of the bank's condition at the time the particular deposit was received.' *State v. Quackenbush*, 98 Minn. 515, 108 N. W. 953. Construing a statute subjecting an officer who 'has good reason to know' the insolvent condition to the offense, the same court says, in continuing: 'This rule is consistent with the general principle that a person is presumed to know what it is his duty to know'—citing cases. In *State v. Cadwallader*, 154 Ind. 607, 57 N. E. 512, it is said: *'It is the imperative duty of such officers, when they receive deposits from the bank's patrons, to know that the bank is solvent, if under the circumstances, by the exercise of reasonable diligence, such fact could*

*have been ascertained.* If, by the exercise of such diligence in making an examination and inquiry in respect to the solvency or insolvency of the bank, its true condition could have been discovered, then, under such circumstances, the presumption will be that they had knowledge.' See, also, *Meadowcroft v. People*, 163 Ill. 56, 45 N. E. 991, 35 L. R. A. 176, 54 Am. St. Rep. 447; *McClure v. People*, 27 Colo. 358, 61 Pac. 612; *State v. Buck*, 120 Mo. 479, 25 S. W. 573. 'Good reason to believe' implies not only knowledge, but an investigation into such facts as would give knowledge. *Such investigation means, not a haphazard, casual investigation, but a reasonable investigation, diligent inquiry, and prudent search.*" (Italics ours.)

*State v. Welty*, 65 Wash. 244; 118 Pac. 9, 15.

"It was only about one month from the date of the deposit until defendant's bank failed and closed its doors. This, of itself, had a strong tendency to show that the bank was in failing circumstances, if not, in fact, insolvent, at the time the deposit was received; and the law which makes its failure so recently thereafter prima facie evidence of knowledge upon the part of its officers that it was insolvent or in failing circumstances at that time is neither unjust nor unconstitutional. As a banker, it was defendant's business to know the financial condition of his bank at any and all times."

*State v. Buck* (Mo.), 25 S. W. 573, 577.

See also:

*St. Louis and San Francisco R. Co. v. Johnston*, 133 U. S. 566; 33 L. Ed. 683, 686.

*McClure v. People* (Colo.), 61 Pac. 612, 617.

*Wasson v. Hawkins*, 59 Fed. 233, 234.

*Clark Sparks & Sons Horse & Mule Co. v. Americus National Bank*, 230 Fed. 738, 740.

*Orme v. Baker*, 74 Ohio St. 338; 78 N. E. 439, 444; 113 Am. St. Rep. 968.

The trial court, apparently, based the decision in this case on certain language used by Judge Gray in the case of *Quinn v. Earle*, 95 Fed. 728, 732 (R. 71). However, the facts in that case were entirely different from those in the instant case.

In that case, the evidence clearly showed that a plan had been worked out, which had been agreed upon, whereby the indebtedness of the Cashier to the bank would be paid, and that the payment of this indebtedness would make the bank absolutely solvent. The persons who had agreed to furnish money to carry out said plan were so confident of the success of the same that they had advanced $125,000.00 on December 21st and 22nd to carry the bank through the Clearing House on the morning of December 23rd, when it was expected a payment of $643,000.00 would come to the bank which would have made it solvent. The Cashier had powerful friends, a syndicate of ample financial strength had been actually formed to put him in a position to relieve the bank of its embarrassment. The

examination of the books of the bank had not been made at the time the deposit was received and, prior to the examination of the books, the officers of the bank, the Bank Examiner and the persons who were to furnish the money were confident that the plan would be carried out. This plan had been subscribed to by members of the Clearing House of Philadelphia, Presidents of Banks and Trust Companies, and provided for payment of $643,000.00 in cash to the bank on account of the Cashier's indebtedness, to be paid on the morning of December 23, 1897. The examination was completed on the night of December 22nd and it was not until after that examination that the plan was abandoned. Immediately the bank was closed.

In the instant case, the examination of the books of the bank had been completed on the night of March 13, 1921, and the only hope which the officers had for relieving the situation had been abandoned (R. 230, 234). The assessment on the capital stock had been levied and the Cashier had not paid, and could not pay, his assessment or redeem his stock from the bank where it was placed as collateral (R. 230). He was so insolvent that it was useless to present any claims against his estate (R. 102, 103). The officers were facing a special examination by the Bank Commissioner if they could not show progress by March 15th (R. 229). In view of the knowledge acquired by the officers as a result of the examination of the assets of the bank, they

knew that a special examination of the bank could result in only one action, which was closing the bank, and clearly the Cashier, being absolutely insolvent, and having failed to raise any money from December 13th, 1920 (when he was notified that progress must be made before March 15, 1921 (R. 229), to March 13th, 1921, knew that any plan which depended on his furnishing over $96,000.00 in cash must fail. Furthermore, there is no evidence that he had any promise of assistance or that the other officers believed he could raise the money. The evidence, on the contrary, clearly shows that the assistant cashier and the president believed he could not do so (R. 234).

Clearly, the facts in the instant case are not similar to those in the case of *Quinn v. Earle*, *supra*, and justify entirely opposite conclusions. Furthermore, the particular language which the court quoted from the *Quinn* case was not necessary to a decision in that case and is contrary to the well established rule that the law holds bankers to a higher degree of care and responsibility than individual traders or merchants.

*St. Louis & San Francisc Co. v. Johnston*, 133 U. S. 566; 33 L. Ed. 683, 686.

*Hyland v. Roe* (Wis.), 87 N. W. 252, 253.

*Higgins v. Hayden* (Neb.), 73 N. W. 281, 282.

*State v. Welty* (Wash.), 118 Pac. 9, 15.

3 R. C. L. 494, 495.

RIGHT TO RECOVER DEPOSITS MADE IN INSOLVENT BANK, OR THEIR PROCEEDS.

The law, relative the right of a depositor to recover deposits made in an insolvent bank, or their proceeds, is clearly stated by the authorities as follows:

> "Deposits taken by an insolvent bank under circumstances which are a fraud on the depositor are not included in the assignment and may be recovered by the owner.
>
> "(2) What is Fraudulent Receiving. If the depositor would not have left his money had he known as much as the officers about the bank's condition, or if its condition was misrepresented to him with the view of influencing his conduct and had that effect, the taking of his deposit under these circumstances is a fraud on the depositor."
>
> 5 Cyc. 564.
>
> "When a bank becomes insolvent it should decline to receive further deposits and should discontinue business; and if under such circumstances it continues to receive deposits, this is a fraud on depositors, and title to a deposit so received remains in the depositor who may follow and recover it, if it augmented the assets of the bank and can be identified. Acceptance of a deposit is a fraud within this rule, where the depositor would not have left his money had he known as much as the officers did about the bank's condition, or if its condi-

tion was misrepresented to him with the view of influencing his conduct and had that effect;"

7 C. J. 730.

"A deposit obtained by fraud, when a bank is hopelessly insolvent, creates a trust in favor of the depositor, and can be recovered from a receiver of the bank, even if the identical money deposited does not pass into his hands, where the funds received by him are in any event increased by the amount of the deposit, and the fact that the depositor was a stockholder in the bank does not affect his right to recover a deposit so made."

3 R. C. L. 557.

"The general rule, as laid down in a New York case, is that a depositor may recover funds deposited in a bank, if at the time of making the same the officer accepting the same had knowledge of the fact that the bank was hopelessly insolvent. The reason of the rule is, that the deposit is obtained by fraud."

McGee on Banks and Banking (3rd Ed.), 617-618.

The decisions in the Federal Courts are unanimous and exceedingly clear in support of the foregoing rule.

"This bank was hopelessly insolvent when the deposit was made, made so apparently by the operations of a firm of which the president of the bank was a member. The knowledge of the president was the knowledge of the bank.

*Martin v. Webb*, 110 U. S. 7, 15 (28: 49, 52); *Manhattan Bank v. Walker*, 130 U. S. 267 (32: 959); *Cragie v. Hadley*, 99 N. Y. 131. In the latter case it was held that *the acceptance of a deposit by a bank irretrievably insolvent constituted such a fraud as entitled the depositor to reclaim his drafts or their proceeds.* And the Anonymous Case, 67 N. Y. 598, was approved, where a draft was purchased from the defendants, who were bankers, when they were hopelessly insolvent, to their knowledge, and the court held the defendants guilty of fraud in contracting the debt, and said their conduct was not like that of a trader 'who has become embarrassed and insolvent, and yet has reasonable hopes that by continuing in business he may retrieve his fortunes. In such a case he may buy goods on credit, making no false representations, without the necessary imputation of dishonesty. *Nichols v. Pinner*, 18 N. Y. 295; *Brown v. Montgomery*, 20 Id. 287; *Johnson v. Monell*, 2 Keyes 655; *Chaffee v. Fort*, 2 Lans. 81. But it is believed that no case can be found in the books holding that a trader who was hopelessly insolvent, knew that he could not pay his debts and that he must fail in business and thus disappoint his creditors, could honestly take advantage of a credit induced by his apparent prosperity and thus obtain property which he had every reason to believe he could never pay for. In such a

case he does an act the necessary result of which will be to cheat and defraud another, and the intention to cheat will be inferred.' And it was decided that *'in the case of bankers, where greater confidence is asked and reposed, and where dishonest dealings may cause widespread disaster, a more rigid responsibility for good faith and honest dealing will be enforced than in the case of merchants and other traders; and that 'a banker who is, to his own knowledge, hopelessly insolvent, cannot honestly continue his business and receive the money of his customers; and although having no actual intent to cheat and defraud a particular customer, he will be held to have intended the inevitable consequences of his act;* i. e., to cheat and defraud all persons whose money he receives, and whom he fails to pay before he is compelled to stop business.' "

*St. Louis & San Francisco Co. v. Johnston,* 133 U. S. 566; 33 L. Ed. 683, 686.

See also the following cases:

*Wasson v. Hawkins,* 59 Fed. 233, 234.

*Richardson v. New Orleans Co.,* 102 Fed. 780; 52 L. R. A. 67, 68.

*Brennan v. Tillinghast,* 201 Fed. 609, 615.

*In re Silver,* 208 Fed. 797, 799.

*McKinney v. U. S. Nat'l. Bank,* 242 Fed. 48, 51 (C. C. A. 9th Circuit).

*Titlow v. McCormick,* 236 Fed. 209 (C. C. A. 9th Circuit).

*Schuyler v. Littlefield*, 232 U. S. 707; 58 Law Ed. 806.

The same rule is applied in the State courts.

*Cragie v. Hadley*, 99 N. Y. 131, 134.

*Hyland v. Roe*, 111 Wis. 361; 87 N. W. 252, 253.

*Higgins v. Hayden*, 53 Neb. 61; 73 N. W. 281, 282.

*Orme v. Baker*, 74 Ohio St. 337; 78 N. E. 439; 113 Am. St. Rep. 968.

### Treasurer's Deposit Traced.

After the close of Bank on March 14th, 1921, Mr. Stewart took the Pope & Talbot draft of $32,897.97, deposited that day by the County Treasurer, into the United States National Bank. It was not deposited. He there surrendered it, duly endorsed, and received the warrants (R. 163, 164, 170, 171). The transaction either constituted a repurchase, by the Kelso State Bank, of these warrants, or the payment of an indebtedness with this specific money and the release of the collateral which secured the indebtedness. In either event, appellants are entitled to the warrants. If it was a purchase, then the County Treasurer's money has been traced into the proceeds of the money. If it was used to pay a debt, then the collateral securing the debt is available to the County Treasurer, and to appellants, as sureties to him. In neither event are the general creditors of the Kelso Bank injured. The deposit never became, in law, a part of the assets of the

Kelso Bank. If the County Treasurer had purchased the warrants from the Bank directly with this money, the general creditors of the Kelso Bank could not claim it. If the County Treasurer had purchased, directly, the obligation due by the Kelso Bank to the United States National Bank, the general creditors of the Kelso Bank would not have been injured, and such purchase would have carried with it the collateral, viz., the warrants.

Authorities to the effect that a *cestui que trust* is not entitled to a general lien upon the assets of an insolvent trustee, where such trust funds have been used to pay debts of the trustee Bank, are cases where the debts are *unsecured.* To hold otherwise in such case is to deplete the fund available for the general creditors of the Bank. Such is not the result here in allowing appellants the proceeds of the investment of the County Treasurer's funds.

It is well settled that, where a trust fund is used to pay a mortgage or other lien on the property of the trustee, the *cestui que trust* is given a lien on the property commensurate with the trust fund used to discharge the encumbrance.

*Standish v. Babcock* (N. J.), 29 Atl. 327, 329-330.

*Hanna v. McLaughlin* (Ind.), 63 N. E. 475, 476.

"No right is more fully recognized than the right of a *cestui que trust* to pursue and recover trust funds wrongfully diverted, provided their identity has not been lost and they

have not passed into the hands of a bona fide purchaser for a valuable consideration without notice. Whenever property in its original state and form has once been impressed with the character of a trust, no subsequent change of such state and form can divest it of its trust character, so long as it is capable of clear identification; and the beneficiary of the trust may pursue and reclaim it in whatever form he may find it, unless it has passed into the possession of a bona fide purchaser without notice. Whether a disposition of trust funds be rightful or wrongful, the beneficial owner is entitled to the proceeds whatever be their form, if he can identify them.

26 R. C. L. 1348, 1349.

WARRANTS PLEDGED AS SECURITY FOR DEPOSITS OF COUNTY TREASURER IN THE KELSO STATE BANK.

The second ground upon which appellants claim the right to recover the warrants in question is based upon the fact that said warrants were pledged with the United States National Bank of Portland as security for the deposits of county funds which the County Treasurer of Cowlitz County had in the Kelso State Bank. In the opinion of the trial court, it is stated:

"The evidence is clear that the purpose of the Kelso Bank in leaving the warrants with the United States Bank was not to secure deposits of county funds already made, but in

the hope that it would be able to obtain future deposits of such funds" (R. 72).

It is our contention that this statement is contrary to the evidence and is not supported by any competent evidence.

The only parties to the transaction whereby the warrants were left with the United States National Bank by the Kelso State Bank were Mr. Stewart, Cashier of the Kelso State Bank, who has disappeared, and Mr. Tucker, Vice-President of the United States National Bank of Portland. Mr. Tucker's testimony is as follows:

> "When these warrants were repurchased, Mr. Stewart instructed us to place the warrants in safekeeping, in our safekeeping department, to issue a receipt for those warrants, send that receipt to the County Treasurer Brown and to call him on the long distance telephone and apprise him of that fact, which we did.
>
> "We thought that we did send that receipt to the County Treasurer, but we have heard since that it did not arrive in his hands. By mistake, it had been sent to the Kelso State Bank" (R. 165).
>
> "When Mr. Stewart came in he had this interview with me, and I placed the warrants in our safekeeping department, and instructed the teller in charge to issue a receipt" (R. 170).
>
> "When Mr. Stewart came in, he stated that he had received his county funds, and was ready to retire the warrants we were holding

under the repurchase agreement; he also requested us to place the warrants in safekeeping, and to telephone the County Treasurer that we were holding them for his account.

"When I stated a few moments ago, that we subsequently had no interest in these warrants, and held them for Mr. Stewart or any one he might designate, perhaps that ought to be explained. Suppose the bank had continued open, and Mr. Stewart had asked us at a later date to make some other disposition of the warrants other than that called for by the receipt which we had given, we would not have honored that request until we had been relieved of issuing the receipt to the County Treasurer. In other words, we would not have consented to any disposition of those warrants which was not approved of by the County Treasurer, or those who had succeeded to his interest" (R. 174, 175).

"Particularly referring to Plaintiff's Exhibit 5, in stating that I would not have given these warrants up because of this outstanding receipt to the Treasurer, I am saying that we assumed they were deposited under his jurisdiction; we had made an agreement to hold them, and we were going to do it. If the County Treasurer had demanded those warrants, we would have turned them over to him without any more authority from Mr. Stewart. But he never demanded them" (R. 175).

The receipt which was issued by the United States National Bank under Mr. Stewart's instructions read as follows:

"THE UNITED STATES NATIONAL BANK.

Portland, Oregon, 3/14/21.

No. 1469.

Received from Kelso State Bank.

Address: Kelso, Washington,

For safekeeping only and at your risk securities purporting to be as follows:

Cowlitz County Warrants .....33,491.59

NOT NEGOTIARLE

Held as security for deposits of county funds —County Treas., Kalama, Washington.

(Rubber Stamp) PAUL S. DICK,
Cashier-Pres.

(Signed) W. R. CHOATE,
Teller" (R. 263).

And had attached thereto a list of the warrants (R. 264-276).

The receipt states that the warrants are held as security for deposits of county funds. It does not state whether it secures deposits already made or those to be made in the future, or both.

Section 5073 Remington's Code, 1915, of the State of Washington provides that the County Treasurer may accept either surety bonds, municipal, school district, county, state bonds or warrants, as security for deposits made in banks. Said section reads as follows:

"Section 5073. Bond—Approval of—Securi-

ties in Lieu of.——Before any such designation or designations shall become effectual and entitle the said treasurer to make deposits in such bank or banks, the bank or banks so designated shall within ten days after such designation or designations have been filed, file with the county clerk of such county a surety bond to such county treasurer, properly executed by some reliable surety company qualified under the laws of this state to do business therein, in the maximum amount of deposits designated by said treasurer to be carried in such bank or banks, conditioned for the prompt and faithful payment thereof on checks drawn by such treasurer, which bond much be approved by the chairman of the board of county commissioners, the prosecurting attorney and the county treasurer, or any two of such officers of said county, before being filed with the county clerk, and unless so approved the same shall not be received or filed by the county clerk; Provided, that said depositary or deporitaries may deposit with the county treasurer good and sufficient municipal, school district, county or state bonds or warrants, United States bonds, first mortgage railroad bonds listed on the New York stock exchange, or local improvement bonds or warrants whose legality have been passed upon favorably by the supreme court, or public utility bonds or warrants issued by or under the authority of

> any municipality of the state for water, power or light plants or maintenance thereof upon which principal or interest is not in default at the time of such deposit, the aggregate market value of which shall not be less than the amount required in said deposit, in lieu of the surety bond herein provided for. (R. 47, 48).
>
> Sec. 5073 Rem. Code of the State of Washington, 1915.

If, instead of depositing warrants with the United States National Bank on March 14th, 1921, the Kelso State Bank had delivered to the County Treasurer a surety bond conditioned to secure deposits in the Kelso State Bank, we believe that the courts undoubtedly would hold that the bond covered deposits already in the bank as well as deposits thereafter made. While it is true that the deposits already made did not exceed the amount of the bonds held by the County Treasurer, the same rule should be applied, in the instant case, as would be applied if the Kelso State Bank had, on the 14th day of March, 1921, delivered a surety bond in the sum of $33,000.00 to the County Treasurer and one of the surety companies on the original bonds had become insolvent. In such case a bond conditioned to secure deposits of the County Treasurer in the Kelso State Bank, would cover deposits made *before* the time of its execution, as well as those made thereafter.

It is a matter of common knowledge, of which the courts will take judicial notice, that a great

number of bonds are executed after the person bonded has come into possession of money or property belonging to the obligee, and, in all such cases, the bonds cover money or property received prior to their execution, as well as that received afterwards. The warrants having been pledged in lieu of a surety bond, the County Treasurer should have the same protection under the pledge that he would have had under a bond.

This transaction amounted to nothing more than pledging warrants as additional security for a prior indebtedness. It would have been just as logical for the court to have held that the warrants were pledged to cover deposits already made, thereby increasing the amount that could be deposited under the bonds, and that all future deposits were to be covered by the bonds alone, as to hold that the warrants were only to cover future deposits.

It seems clear that *the intention of the parties was to have all the securities available to the County Treasurer to cover all of the deposits which he had made or might thereafter make.*

The record is devoid of testimony that the warrants were pledged to secure the Treasurer as to subsequent deposits only.

The pre-existing indebtedness was a sufficient consideration to support the pledge.

31 Cyc. 795, 796.

21 R. C. L. 662.

See also:

*Thomas v. Graves* (Vt.), 95 Atl. 643,

in which case the pledge was given as additional security for a prior indebtedness.

Since the pledge of the warrants was for the benefit of the County Treasurer, a formal acceptance of the same was unnecessary.

26 R. C. L. 1190.

*Martin v. Funk*, 75 N. Y. 134; 31 Am. Rep. 446.

*Rogers Locomotive Works v. Kelly*, 88 N. Y. 234, 238.

*Scott v. Harbeck*, 49 Hun. 292, 293.

*Zwietusch v. Becker*, 153 Wis. 213; 140 N. W. 1056.

*City of Marquette v. Wilkinson*, 119 Mich. 413; 78 N. W. 474; 43 L. R. A. 840.

*Beattie Manufacturing Company v. Clark*, 208 Mo. 89; 106 S. W. 29, 34.

A surety may sue on a contract made for the payment of the principal's debt, although neither surety nor principal is a party to the contract.

*Van Meter v. Poole*, 119 Mo. App. 296; 95 S. W. 960, 961.

TRUST FUNDS REMAINED AN BANK.

The County Treasurer's deposit of March 14, 1921, in the Kelso State Bank amounted to $35,-337.57 (R. 206, 207). Of this amount $33,491.59 was used to purchase the warrants from the United States National Bank (R. 165), and the difference, amounting to $1,845.98 remained in the bank until it closed. The record shows the least amount of

cash in the bank after the 14th day of March, 1921, was the sum of $17,189.32 (R. 93). Appellants are entitled to recover said sum of $1,845.98 under their second cause of action.

26 R. C. L. 1357, 1358.

*Clark Sparks & Sons v. Americus National Bank*, 230 Fed. 738.

*Carlson v. Kies*, 75 Wash. 171; 134 Pac. 808.

*Merchants Bank v. School District*, 94 Fed. 705 (C. C. A. 9th Circuit).

It is respectfully submitted that the judgment of the trial court should be reversed, and a decree entered in favor of appellants.

McCamant & Thompson and
Grinstead & Laube,
*Solicitors for Appellants.*
Wallace McCamant and
Loren Grinstead,
*Of Counsel.*